



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Number: **201244021**
Release Date: 11/2/2012

Date: August 9, 2012

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

UIL: 501.00-00; 501.03-00; 501.03-05; 501.32-00;
501.33-00

Dear _____ :

This is our final determination that you do not qualify for exemption from Federal income tax under Internal Revenue Code section 501(a) as an organization described in Code section 501(c)(3).

We made this determination for the following reason(s):

First, you failed to provide sufficient information in your Application to enable us to determine that you are eligible for recognition of exempt status. Second, you failed the organizational test because you did not provide a copy of your Articles of Incorporation. You also fail the operational test because you will be engaging in activities that are commercial and do not have an exempt purpose. Third, you will impermissibly operate for the benefit of your founder and his for-profit entity. Finally, your net earnings will likely inure to the benefit of your founder.

Because you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

If you decide to contest this determination under the declaratory judgment provisions of Code section 7428, you must initiate a suit in the United States Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia before the 91st day after the date that we mailed this letter to you. Contact the clerk of the appropriate court for rules for initiating suits for declaratory judgment. Filing a declaratory judgment suit under Code section 7428 does not stay the requirement to file returns and pay taxes.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read

the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, you should follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Lois G. Lerner
Director, Exempt Organizations

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: October 25, 2011

Contact Person:

Uniform Issue List:

501.00-00

501.03-00

501.03-05

501.32-00

501.33-00

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND

Taxpayer =
State1 =
Date1 =
Date2 =
State2 =
Founder =
For-profit =
Environmental issues =
Business issue =
Medical Projects =
Environmental Projects =
Military Projects =

Dear :

We have considered your application for recognition of exemption from Federal income tax under § 501(a) of the Internal Revenue Code ("Code"). Based on the information provided, we have concluded that you do not qualify for exemption under § 501(c)(3). The basis for our conclusion is set forth below.

FACTS

You, Taxpayer, are a non-profit corporation formed in State1 on Date1. You submitted a Form 1023 seeking recognition of exemption under § 501(c)(3) on Date2.

You submitted a "Certificate of Incorporation" issued by State1 and dated Date1 but did not provide a copy of your Articles of Incorporation. You also submitted certification from State2 showing that you are registered as a foreign nonprofit corporation in State2. You did not adopt Bylaws and although you stated that you adopted a conflict of interest policy, you did not provide a copy.

You indicated in your application that you would be engaged in a variety of activities. You stated that you would engage in economic development, operate as a cooperative hospital

service organization under § 501(e), operate as a charitable risk pool under § 501(n), operate a school, provide hospital or medical care, provide low-income housing or housing for the elderly or handicapped, provide scholarships, fellowship, educational loans, or other educational grants to individuals, and that you will simultaneously be a publicly supported charity and a private operating foundation.

You partially completed various schedules for the Form 1023, including Schedule B (schools, colleges, and universities), Schedule C (hospitals and medical research organizations), Schedule D (509(a)(3) supporting organizations), Schedule E (organizations not filing Form 1023 within 27 months of formation), Schedule F (homes for the elderly or handicapped or low-income housing), Schedule G (successors to other organizations), and Schedule H (organizations providing scholarships, fellowships, educational loans, or other educational grants to individuals and private foundations requesting advance approval of individual grant procedures).

You also submitted a copy of your business plan. In this document, you list several of your objectives. These include demanding changes to laws regarding Environmental issues and a Business issue. You also state that your purposes include stopping venture capitalists, Medical projects, building affordable residential homes, providing disaster relief, and preventing divorce. You also provide that you will create a prison and develop new Environmental projects and Military projects.

You have a close relationship with For-profit. That organization shares its director and founder, Founder, with you. In your business plan, you make repeated reference to For-profit and its activities and products. You also filled out Schedule D of the Form 1023 and stated that your supported organization is For-profit. On Schedule D, you provided that you will distribute at least 85% of your income to For-Profit. You also included with your application a single "charter" document for both you and For-profit. You state that you "started" with For-profit, but "decided to start a wonderful NPO Exempt Corporation" because you "failed to secure [your] funding."

On your Application and supporting documentation, you list Founder as your founder, CEO, and chairman. You listed no other officers, directors, trustees, or employees. You stated that Founder's annual actual or estimated compensation is \$250,000.

LAW

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable, educational and other purposes, provided that no part of the net earnings inure to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations ("regulations") provides that, in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(b)(1) of the regulations provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization contain specific language enumerated in this section.

Section 1.501(c)(3)-1(b)(1)(i) of the regulations states that an organization is organized exclusively for one or more exempt purposes only if its articles of organization (a) limit the purposes of such organization to one or more exempt purposes, and (b) do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(b)(1)(iii) of the regulations states that an organization is not organized exclusively for one or more exempt purposes if its articles expressly empower it to carry on, otherwise than as an insubstantial part of its activities, activities which are not in furtherance of one or more exempt purposes, even though such organization is, by the terms of such articles, created for a purpose that is no broader than the purposes specified in § 501(c)(3). Thus, an organization that is empowered by its articles "to engage in a manufacturing business" or, "to engage in the operation of a social club" does not meet the organizational test regardless of the fact that its articles may state that such organization is created "for charitable purposes within the meaning of" § 501(c)(3).

Section 1.501(c)(3)-1(b)(1)(iv) of the regulations states that in no case shall an organization be considered to be organized exclusively for one or more exempt purposes, if, by the terms of its articles, the purposes for which such organization is created are broader than the purposes specified in § 501(c)(3).

Section 1.501(c)(3)-1(c)(2) of the regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. Section 1.501(a)-1(c) of the regulations defines the words "private shareholder or individual" in § 501 to refer to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, to meet the requirements of this subsection, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Rev. Proc. 75-50, 1975-2 C.B. 587 sets forth guidelines and recordkeeping requirements regarding racially nondiscriminatory policies for private schools that are applying for recognition of exemption under § 501(c)(3).

Rev. Proc. 2011-9, 2011-2 I.R.B. 283, section 4.03 provides that exempt status may be recognized in advance of the organization's operations if its proposed operations are described in sufficient detail to permit a conclusion that it will clearly meet the particular requirements for exemption pursuant to the section of the Code under which exemption is claimed. Section 4.03(2) states that the organization must fully describe all of the activities in which it expects to engage, including the standards, criteria, procedures or other means adopted or planned for

carrying out the activities, the anticipated sources of receipts, and the nature of contemplated expenditures.

In Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. The Court found that a trade association had an "underlying commercial motive" that distinguished its educational program from that carried out by a university, and therefore, the association did not qualify for exemption.

In Church by Mail v. Commissioner, 765 F.2d 1387 (9th Cir. 1985), aff'd 48 T.C.M. (CCH) 471 (1984), the court found that it was unnecessary to consider the reasonableness of payments made by the applicant to a business owned by its officers. The court noted that "the critical inquiry is not whether particular contractual payments to a related for-profit organization are reasonable or excessive, but instead whether the entire enterprise is carried on in such a manner that the for-profit benefits substantially from the operation of the Church."

The organization has the burden of providing sufficient documentation or other substantive information regarding its activities and operations, which would establish entitlement to tax exempt status, including establishing that its net earnings will not inure to the benefit of private individuals and that it will not serve private interests. See, e.g. Harding Hospital, Inc. v. United States, 505 F.2d 1068 (6th Cir. 1974); Founding Church of Scientology v. United States, 412 F.2d 1197, 1200, 1202 (Ct.Cl. 1969); Church of Technology v. United States, 26 Cl.Ct. 713, 737 (1992); Share Network Foundation v. Commissioner, 78 T.C.M (CCH) 6 (1999).

New Dynamics Foundation v. United States, 70 Fed. Cl. 782 (2006), was an action for declaratory judgment that the petitioner brought to challenge the denial of his application for exempt status. The court, in finding that the actual purposes displayed in the administrative record supported the Service's denial, stated "It is well-accepted that, in initial qualification cases such as this, gaps in the administrative record are resolved against the applicant." The court noted that if the petitioner had evidence that contradicted these findings, it should have submitted it as part of the administrative process. The court also highlighted the principle that exemptions from income tax are matters of legislative grace.

In Bubbling Well Church of Universal Love v. Commissioner, 74 T.C. 531, 534-535 (1980) aff'd, 670 F.2d 104 (9th Cir. 1980), the Tax Court explained that an organization that is closely-controlled by related individuals must clearly demonstrate that private interests will not be served and that net earnings will not inure to the benefit of insiders. Given the control over the petitioner organization by related individuals, the court could not conclude "from the information in the administrative record that part of the net earnings did not inure to the benefit of the [controlling] family or, stated another way, that petitioner was not operated for the [family's] private benefit." In reaching this conclusion, the court noted that the situation:

. . . calls for open and candid disclosure of all facts bearing upon petitioner's organization, operations, and finances so that the Court, should it uphold the claimed exemption, can be assured that it is not sanctioning an abuse of the revenue laws. If such disclosure is not made, the logical inference is that the facts, if disclosed, would show that petitioner fails to meet the requirements of section 501(c)(3).

In La Verdad v. Commissioner, 82 T.C. 215 (1984), an organization was formed to provide education and charity, but failed to provide sufficient details regarding its proposed operations. The court held that it failed to prove that it would operate exclusively for exempt purposes under § 501(c)(3) of the Code.

In Church of Eternal Life and Liberty, Inc. v. Commissioner, 86 T.C. 916 (1986), the court held that a church with only two members was not eligible for recognition of tax exemption because its net earnings inured to the benefit of one of these members. The court noted that where an individual or small group has exclusive control over the management of the organization's funds and is the principal recipient of the distributions of the organization, prohibited inurement is strongly suggested.

In American Science Foundation v. Commissioner, 52 T.C.M. (CCH) 1049 (1986), the Court determined that an organization was not eligible for recognition of tax exemption because it failed to provide sufficient information to permit the conclusion that its activities will be exclusively in furtherance of exempt purposes.

RATIONALE

To qualify for exemption under § 501(c)(3), a taxpayer must demonstrate that it is both organized and operated exclusively for exempt purposes and that no part of its earnings inure to private individuals. § 501(c)(3); § 1.501(c)(3)-1(a)(1). You have not demonstrated that you are organized and operated for exclusively exempt purposes. Additionally, your assets and income may inure to the benefit of your Founder and For-profit. Therefore, we can not recognize you as exempt from taxation. See § 501(c)(3); § 1.501(c)(3)-1(d)(1)(ii).

To be organized exclusively for exempt purposes, an organization's articles of organization must limit its purposes to one or more exempt purposes, and must not expressly empower the organization to engage, other than as an insubstantial part of its activities, in activities which do not further one or more exempt purposes. §§ 1.501(c)(3)-1(b)(1)(i), (iii) and (iv). As noted above, although you submitted documentation that you are incorporated, you did not provide a copy of your Articles of Incorporation. As such, you have not demonstrated that your Articles of Incorporation contain the requisite language and therefore fail the organizational test. § 1.501(c)(3)-1(b)(1).

Additionally, you are not operated for exclusively exempt purposes. An applicant is required to submit sufficient information during the application process for the Service to conclude that the organization is in compliance with the organizational and operational requirements of section 501(c)(3) before a ruling is issued. Rev. Proc. 2011-9, supra. The organization has the burden of establishing through the administrative record that it operates as a § 501(c)(3) organization. American Science Foundation, 52 T.C.M. 1049. Denial of exemption may be based solely upon failure to provide information describing in adequate detail how the operational test will be met. See Id.; La Verdad v. Commissioner, 82 T.C. 215.

Exempt status can be recognized in advance of operations if proposed operations can be described in enough detail to permit a conclusion that the organization will clearly meet the requirements of section 501(c)(3). Rev. Proc. 2011-9, supra; American Science Foundation, 52 T.C.M. 1049. The organization has the burden of providing sufficient substantive information

regarding its activities and operations to establish entitlement to tax-exempt status. See, e.g., Founding Church of Scientology, 412 F.2d at 1200, 1202; Church of Spiritual Technology, 26 Cl.Ct. at 737; Bubbling Well Church of Universal Love, 74 T.C. at 535; Share Network Foundation, 78 T.C.M. at 4-5. Any gaps contained in the administrative record are resolved in favor of the Service. New Dynamics, 70 Fed. Cl. at 802 ("It is well-accepted that, in initial qualification cases such as this, gaps in the administrative record are resolved against the applicant"). Information that is vague or nonspecific is not sufficient to meet the requirements under section 501(c)(3). Share Network Foundation, 78 T.C.M. (CCH) 6.

Your Application does not present adequate information to allow us to determine that you meet the operational test. Your application lists a myriad of activities that you intend to engage in, but did not describe how you will engage in those activities and how those activities further exempt purposes. For example, you state that you will economic development but did not explain how your activities would provide for economic development. You stated that you would operate as a cooperative hospital service organization under § 501(e), provide hospital or medical care and completed Schedule C, but did not provide any details on how you are providing hospital or medical care. Similarly you stated that you will operate a school and completed Schedule B, but did not describe your schools. Additionally, while you stated that your schools would comply with Rev. Proc. 75-50, supra, you also indicated on Schedule B that you have an objective to maintain segregated education. Although some of the activities you list may be exempt activities, you did not provide sufficient information about how you propose to conduct your activities to permit us to determine whether they will advance these purposes as required by Rev. Proc. 2011-9, Section 4.03. Therefore, you are not operated exclusively for exempt purposes.

An organization will also not be organized and operated exclusively for exempt purposes if it is operated for the benefit of private interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests. § 1.501(c)(3)-1(d)(1)(ii). Your earnings appear to inure to Founder and you appear to operate for the benefit of For-profit rather than for a public interest. Therefore, you are not operated exclusively for exempt purposes.

You stated that Founder is your founder, CEO, and chairman. You did not indicate that you have any other officers, directors, or trustees. You also have not adopted bylaws for the selection of these individuals. You do not have any employees. You stated that you have adopted a conflict of interest policy but did not provide a copy of this document. You also indicated that Founder's annual compensation will be \$250,000 per year. Because Founder is the only person associated with your organization and especially considering your lack of safeguards such as a conflict of interest policy, we believe that your net earnings will ultimately inure to the benefit of Individual. Because your net earnings will most likely inure to the benefit of Founder, you do meet the requirements of section 1.501(c)(3)-1(c)(2) of the regulations. In addition, similar to what the court noted in Church of Eternal Life and Liberty, the fact that you are a single individual with exclusive control over the management and distribution of your organization's funds, "strongly suggests" prohibited inurement. 86 T.C. at 927. Additionally, there are several indicators in your Application that you are operating for the benefit of For-profit. For example, you provided a copy of your and For-profit's charter which explicitly states that you started your organization because For-profit failed to secure funding. In addition, on Schedule D for supporting organizations, you stated that your supported

organization is For-profit. You also indicated on Schedule D that at least 85% of your income will go to For-profit.

Courts have repeatedly held that an organization that operates to provide commercial benefits to a related for-profit has a substantial non-exempt purpose. For example, in Church by Mail v. Commissioner, the court found that it was unnecessary to consider the reasonableness of payments made by the applicant to a business owned by its officers. The court noted that "the critical inquiry is not whether particular contractual payments to a related for-profit organization are reasonable or excessive, but instead whether the entire enterprise is carried on in such a manner that the for-profit benefits substantially from the operation of the Church." 765 F.2d at 1392. Similarly, it appears from a thorough examination of your Application that you founded your organization in order to fund For-profit. In addition, the few activities you were able to describe are so intertwined with those of For-profit that it is difficult to discern the distinction between you and For-profit. Consequently, because you operate for the benefit of Founder and For-profit, you do not qualify for recognition of exemption.

CONCLUSION

Your application for exemption is denied. First, you failed to provide sufficient information in your Application to enable us to determine that you are eligible for recognition of exempt status. Second, you failed the organizational test because you did not provide a copy of your Articles of Incorporation. You also fail the operational test because you will be engaging in activities that are commercial and do not have an exempt purpose. Third, you will impermissibly operate for the benefit of Founder and For-profit. Finally, your net earnings will likely inure to the benefit of Founder. Therefore, you do not qualify for recognition of exemption under section 501(c)(3) of the Code.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination.

Your protest statement should be accompanied by the following declaration:

Under penalties of perjury, I declare that I have examined this protest statement, including accompanying documents, and, to the best of my knowledge and belief, the statement contains all the relevant facts, and such facts are true, correct, and complete.

You also have a right to request a conference to discuss your protest. This request should be made when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. For more information about representation, see Publication 947, *Practice before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to protest

as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848 and any supporting documents to this address:

Internal Revenue Service
TE/GE
1111 Constitution Ave, N.W.
Washington, DC 20224

You may also fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Lois G. Lerner
Director, Exempt Organizations